



COMPREHENSIVE ANALYSIS OF COSTCO'S BUSINESS MODEL

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ABSTRACT

This research paper examines the distinctive elements that constitute the business model of Costco Wholesale Corporation, focusing on its achievements from 2014 to 2024. The paper attributes Costco's success over this decade to a unique business approach grounded in its mission statement and its "membership-only warehouse club" model, which serves as the framework for its operations. The study utilizes various analytical business tools, including Porter's Five Forces, the Ansoff Matrix, and Porter's Generic Strategies, to evaluate the internal and external factors behind Costco's sustained growth. Findings indicate that within Porter's Five Forces framework, competitive rivalry, the bargaining power of consumers, and the threat of substitutes are primary concerns for Costco. In contrast, the bargaining power of suppliers is less critical. Costco's core cost leadership strategy, centered on maintaining low costs and prices, is complemented by differentiation through exclusive membership benefits, distinguishing it within a competitive retail landscape. Market penetration and development emerge as focal points for Costco's current fiscal strategy, evidenced by discounts, savings offers, and international expansions, including new locations in Jiangning, China, Zaragoza, Spain, and three upcoming stores in Japan. The analysis also emphasizes Costco's focus on promotion, pricing, and place within its marketing mix, contributing to its steady growth, exemplified by a 7.75% year-over-year increase, even during economic downturns.

KEYWORDS: Costco Business Model, Retail Industry Analysis, Cost Leadership Strategy, Market Penetration, Porter's Five Forces

INTRODUCTION

Costco Wholesale Corporation is a multinational enterprise (MNE) with 884 stores worldwide as of 2024. Founded on September 15, 1983, in Kirkland, Washington, by Jeffrey H. Brotman and Jim Sinegal, Costco ranks among one of the most financially successful corporations globally. In 2024, it was ranked 11th among the Fortune 500 companies, boasting a market capitalization of \$395.74 billion as of August 2024 and a 7.75% increase in revenue. Operating within the retail sector, Costco is currently the third-largest retail business worldwide. Its extensive product line includes home appliances, jewelry, mattresses, electronics, and even car rentals.

Costco's growth strategy has shown clear results in recent years, with revenue reaching \$253.70 billion in the last twelve months, a 7.75% year-over-year increase. For the fiscal year ending September 3, 2023, Costco reported an annual revenue of \$242.29 billion, marking a 6.76% growth rate (Stock Analysis). This success is attributed to its unique business model, which leverages bulk buying (economies of scale) and large warehouse storage to keep operational costs low and support sales at narrow profit margins. Costco's profit model is bolstered by its membership plan, priced at \$65 annually, which follows a "membership-only warehouse club" approach (Cascade Strategies, 2023). Notably, membership fees generated \$4.6 billion last year, accounting for approximately 73% of its profits (The Motley Fool, 2024).

This research paper explores the various elements of Costco's business model and the contribution of each to its recent success.

Goals and Significance

This research aims to assess Costco's business model and its success over the past decade (2014–2024) using four business analysis tools: (i) the Ansoff Matrix, (ii) the Marketing Mix, (iii) Porter's Five Forces, and (iv) Porter's Generic Strategies. These tools will comprehensively analyze Costco's unique business strategies and how each component has driven its financial growth. This study provides insights into the competitive dynamics of the retail industry and the role of well-defined business models in achieving long-term success. By examining Costco's recent growth trajectory and dissecting the components of its model, this paper seeks to understand how each aspect has contributed to its financial achievements.

METHODOLOGY

This study employs a secondary qualitative methodology to analyze Costco's business model, focusing on its unique approaches to cost leadership, market penetration, and member-focused strategies. This approach involves a comprehensive review of literature, industry reports, and case studies that examine Costco's operational tactics and strategic tools, such as Porter's Five Forces and the Ansoff Matrix. Using secondary sources allows for a broad understanding of how Costco has sustained growth and competitive advantage in the retail sector.

However, a limitation of this methodology is the reliance on pre-existing data, which may not capture the latest changes in Costco's business strategies or external factors impacting the market.

Costco's Mission Statement

At the core of Costco's business model is its mission statement, which guides the company's strategies and objectives. A mission statement is central to any business model as it establishes the primary goal while supporting strategies to fulfill that mission. Costco's mission statement and accompanying Code of Ethics form the foundation for all aspects of its business model and strategic decisions.

Costco's Mission Statement and Code of Ethics

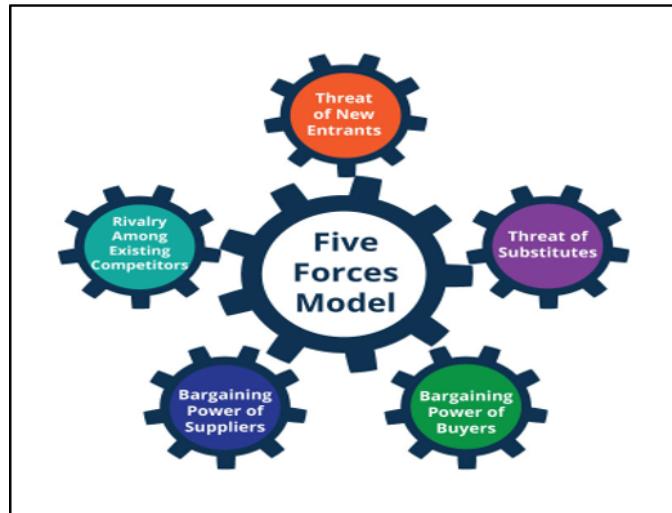
(Adopted from Costco)

"Here at Costco, we have a very straightforward but important mission: to continually provide our members with quality goods and services at the lowest possible prices. To achieve our mission, we will conduct our business with the following Code of Ethics in mind:

- Obey the law.
- Take care of our members.
- Take care of our employees.
- Respect our suppliers.

If we do these four things throughout our organization, then we will achieve our ultimate goal, which is to reward our shareholders."

Costco's Porter's 5 Forces



Source: Platinum Pro

Figure 1: Porter's 5 Forces

Porter's Five Forces, first published in the Harvard Business Review in 1979 by Michael Porter, analyzes the competitive forces within an industry. The five forces—Competitive Rivalry, Supplier Power, Buyer Power, Threat of New Entrants, and Threat of Substitutes—determine the competitiveness and profitability of an industry. This section specifically applies Porter's Five Forces to the retail industry, where Costco operates. Each force will be broken down into specific factors impacting Costco's competitiveness, followed by an overall

rating ranging from High, Moderate, or Weak.

Costco Competition/Competitive Rivals

Industry Growth: The retail industry was valued at USD 21,237.64 billion in 2022 and is projected to reach USD 41,368.44 billion by 2030, growing at a CAGR of 7.69% from 2023 to 2030 (Verified Market Research, 2024). Although not growing as fast as sectors like IT or renewable energy, the retail industry's large size and steady expansion make it a stable, significantly growing sector.

Force: Moderate

Number of Competitors: Costco faces significant competition from retail giants such as Amazon, Walmart, Target, Whole Foods, Home Depot, Carrefour, Best Buy, Aldi, and numerous mid-sized and local stores.

Force: High

Similarities in what's offered: Costco's products and services are relatively homogenous compared to competitors in the retail industry.

Force: High

High Exit Barriers: Costco has high exit barriers due to its extensive investments in trucks, warehouses, and infrastructure across various retail sectors. Exiting the industry would be costly due to these fixed assets.

Force: High

Overall Competitive force: High

Supplier Power

Number of Suppliers: Costco deals with a wide range of suppliers, reducing the bargaining power of any individual supplier. The absence of a single supplier will not significantly impact Costco's operations.

Force: Weak

Switching Costs: For a large retailer like Costco, there is considerable competition among suppliers to secure a contract. Thus, switching costs are low as Costco's product line includes a variety of goods that are not dependent on unique suppliers.

Force: Weak

High Supply and Low Forward Integration: There is an abundance of suppliers, and most have low forward integration, meaning they do not have significant control over their products once they reach Costco's warehouses.

Force: Weak

Overall Supplier power: Weak force

Buyer Power

Switching Costs: Consumers face low switching costs when choosing where to shop, as many businesses offer similar products at comparable prices.

Force: High

Number of Buyers: Costco serves a broad customer base

across various demographics, benefiting from its established brand and low prices.

Force: High

Availability of Substitutes: Consumers have numerous alternatives to Costco's offerings, increasing their bargaining power. The ease of switching to other retailers for the same products gives consumers more control over their choices.

Force: High

Threat of Substitutes or Substitution

Customer Willingness to go Elsewhere: Customers are willing to shop at competitors if they believe they can find better deals or more attractive alternatives.

Force: High

Availability of Close Substitutes: Many substitutes, similar or nearly identical to Costco's products, are available due to the relatively homogenous nature of the retail industry.

Force: High

Overall force: High force

Threat of New Entrants: Costco benefits from large economies of scale, particularly through bulk purchasing, which provides a significant cost advantage over potential new entrants.

Force: Weak

Shoppers' low switching costs: With low switching costs for consumers, new entrants can capture market share relatively easily.

Force: High

Barriers to Entry: Although the retail industry has relatively low entry barriers, new entrants still face significant challenges in terms of fixed costs, regulatory requirements, and the need for substantial capital investment.

Force: Moderate

Overall force: Moderate force

Porter's Five Forces	Strength of force
Competitive rivalry	High
Bargaining power of buyers/consumers	High
Bargaining power of suppliers	Weak
Threat of substitutes or substitution	High
Threat of new entrants or new entry	Moderate

Porter's Five Forces analysis reveals that Costco faces significant challenges in three out of the five forces—Competitive Rivalry, Buyer Power, and Threat of Substitutes—all of which are high. The company also faces moderate difficulty with the Threat of New Entrants. The weakest force impacting Costco is Supplier Power, which is of minimal concern due to Costco's ability to switch suppliers easily and its reliance on a wide range of suppliers.

Ansoff Matrix Analysis

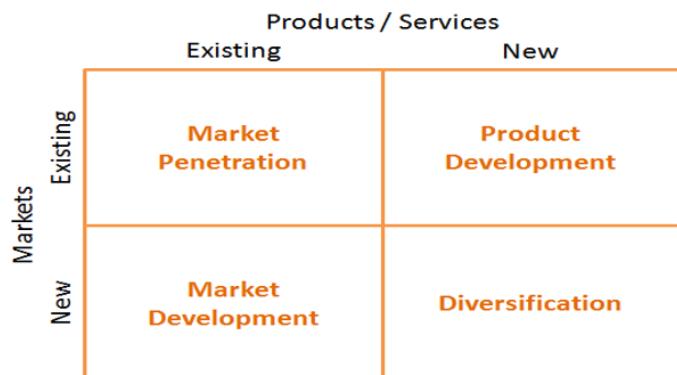


Figure 2: Adopted from Strategic Coffee

The Ansoff Matrix is “a strategic planning tool that provides a framework to help executives, senior managers, and marketers devise strategies for future business growth” (Wikipedia, 2024). Developed by Russian-American strategist Igor Ansoff, it outlines four growth strategies—market penetration, market development, product development, and diversification—each with varying levels of risk. Below is an analysis of how Costco employs these strategies:

Market Penetration: Costco's market penetration strategy is primarily based on its membership model. Members pay a fee of \$65 (for Gold Star and Business memberships) or \$130 (for Executive membership) to access Costco's warehouses, where they enjoy discounted products. Costco further encourages retention and attracts new members with benefits, such as holiday savings offers, resale eligibility, and exclusive discounts on Costco travel services. This strategy is considered the least risky as it involves penetrating existing markets with the same products.

Market Development: Costco's market development strategy involves expanding into new geographical areas, specifically international markets. Recent expansions include Costco's stores in Jiangning, China, and Zaragoza, Spain, with three additional locations planned in Japan. These stores offer the same product assortment as their U.S. counterparts, which helps mitigate risk, as consumer demand for essential goods is global and not heavily influenced by regional preferences (Verified Market Research, 2024). While this expansion strategy does carry some risks due to cultural and market differences, Costco's broad product range reduces the impact of such risks.

Product Development: Costco has also ventured into product development, particularly with changes to its food court offerings. For example, by 2024, Costco will be introducing sushi at certain locations, alongside new food options like chocolate chip cookies and chocolate ice cream. Additionally, Costco is remodeling its app to facilitate a more seamless experience between online and in-store shopping. These innovations in product offerings are designed to attract and retain customers, enhancing the overall shopping experience.

Diversification: While not a primary focus, Costco's

diversification strategy involves adding new products and entering new markets simultaneously. In 2024, Costco introduced Swiss-crafted gold, which became available in select stores in Japan, with a limit of five pieces per membership for pre-order. This diversification into luxury goods, alongside the opening of new store locations, represents an attempt to appeal to different market segments, although it carries a higher risk than the other strategies.

Porter's Generic Strategy: Costco

Porter's generic strategy framework categorizes competitive strategies into three main types: (i) focus, (ii) cost leadership, and (iii) differentiation. Costco Wholesale Corporation primarily employs a cost leadership strategy, leveraging its bulk-buying capabilities and large-scale warehouses to achieve economies of scale. This approach allows Costco to keep average costs low by minimizing transportation and storage expenses, enabling the company to offer lower prices to consumers and appeal broadly in the competitive retail sector.

Costco's revenue model is also shaped by this strategy, as a substantial portion of income is generated through high sales volume achieved by offering quality products at narrow profit margins. This approach has led to a loyal customer base, with a membership renewal rate of 93% as of 2024. In addition to cost leadership, Costco incorporates an element of differentiation through its unique membership model. This model, which accounts for the majority of Costco's profits, incentivizes membership renewals with exclusive benefits, such as discounted products and access to special savings and travel offers, thereby reinforcing customer loyalty and further distinguishing Costco from its competitors.

4Ps Market mix

Product in Costco's 4Ps Marketing mix

The 4 Ps marketing mix, introduced by E. Jerome McCarthy, is essential to any effective marketing strategy and comprises Product, Price, Place, and Promotion. Costco's product line, though narrower than some competitors, covers a wide array of goods and services, giving it a competitive edge as a "one-stop shop." This array includes:

1. Appliances
2. Auto & Tires
3. Baby, Kids & Toys
4. Clothing & Handbags
5. Computers & Printers
6. Electronics
7. Furniture
8. Grocery, Floral & Pets
9. Holiday, Gifts & Tickets
10. Home Improvement
11. Health & Beauty
12. Home, Kitchen, Bed & Bath
13. Jewelry & Watches
14. Office Products
15. Patio & Outdoor
16. Sports & Fitness
17. Travel & Luggage
18. Photo Center services
19. Optical services
20. Hearing Aid Center services
21. Gasoline
22. Business Services
23. Home Services
24. Life Services

Adopted from Andrew Thompson's 4Ps of Marketing

Costco's recent diversification efforts demonstrate its ability to adapt and expand to meet consumer demand. Additional services offered, such as photo printing and life insurance, reinforce Costco's competitive advantage in convenience and variety (Thompson, 2024).

Price in Costco's 4Ps Marketing mix

Costco employs a market-oriented pricing strategy, setting prices based on current market conditions. This aligns with its mission to offer quality goods at affordable prices, helping to retain customers while driving revenue growth even during economic downturns. Additionally, Costco uses high-low pricing, attracting consumers with low-priced staples while encouraging them to browse and purchase higher-margin items.

Place in Costco's 4Ps Marketing mix

Costco operates primarily through its warehouses, allowing customers to browse and purchase goods in-store. Costco's app and e-commerce website are well integrated, offering a seamless purchasing experience for both in-person and online shoppers. This combination of physical and digital platforms strengthens Costco's customer connections and enhances sales.

Promotion in Costco's 4Ps Marketing mix

Costco's promotions emphasize value and trustworthiness. Bulk purchase discounts appeal to businesses, while seasonal discounts and member-exclusive deals incentivize consumer spending. Another key component of Costco's promotion strategy is public relations, which reinforces its brand reputation. Initiatives such as the zero-waste program and sustainability efforts, including using 75% recycled plastic for its popular \$4.99 rotisserie chicken, align with Costco's values. Publicizing its mission statement has also helped build consumer trust and bolster Costco's brand image.

CONCLUSION

In conclusion, Costco's remarkable success in recent years is a direct result of its effective business model and the strategic implementation of growth initiatives. Despite facing high competitive pressures, strong buyer power, and threats of substitution (Porter's Five Forces), Costco's strategic emphasis on cost leadership (Porter's Generic Strategies) allows it to maintain low costs and high sales volumes through bulk purchasing and large warehouse operations, ultimately offering customers the best possible prices in line with its mission statement. Costco also demonstrates an element of differentiation with its membership-based warehouse model, which generates the bulk of the company's profits (73% of 2024's profits) while keeping customers satisfied with competitively low membership fees and an increasingly diversified in-store selection (supported by Costco's high-low

pricing and market-oriented pricing strategies, as outlined in the 4 Ps Marketing Mix).

Costco's business model is robust and flexible, allowing for multiple avenues of growth, with primary focus areas on market penetration and market development. Additionally, Costco's dedication to public relations through sustainability initiatives and action programs that align with its mission statement has contributed to its continued profitability, high customer retention (as demonstrated by a strong renewal rate), and steady market expansion, even in challenging economic periods, including recessions and stagflation.

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